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On

A Critical Evaluation of Foreign Direct Investment and Foreign Portfolio Investment on Indian Economy

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INTRODUCTION

One of the most prominent developments of ninety's era is the stunning growth of Foreign Direct Investment and Foreign Portfolios Investment in the global economic landscape. Foreign direct investment (FDI) is an ownership stake in a foreign company or project made by an investor, company, or government from another country. It is a key element in international economic integration because it creates stable and long-lasting links between economies. Foreign Portfolios Investment (FPI) consists of securities and other financial assets held by investors in another country. It includes stocks, ADRs, GDRs, bond, mutual funds, and exchange traded funds. Along with Foreign Direct Investment, FPI is one of the common ways for investors to participate in an overseas economy. The growth of investments is significant and vital components of development strategy in both developing and developed economies and polices are designed to stimulates inward flows accordingly. FDI and FPI provides opportunity to host and home countries as both countries are directly interested in inviting FDI and FPI because economies gets advantage like acquiring a source of material, expanding a company's footprint, diversification of risk and purchasing of stocks, bonds and debentures. On the other hand host countries access benefits like transfer of technology and innovation, increase employment and income, improved infrastructure and market access, and positive spillovers and linkages. Further it not only integrates the economy but also contribute to its economy growth and social welfare.

AN OVERVIEW OF FOREIGN DIRECT INVESTMENT

The historical background of FDI in India can be traced back with the establishment of east India Company of Britain. During colonial era of Britain, British capital entered into Indian market. After Second World War, Japanese companies entered into Indian market and enhanced their trade with India, at that time U.K remained the most dominant investor in India. Further, after Independence issues relating to foreign capital, operation of MNCs gained attention of the policy makers. Keeping in mind the national interests the policy maker designed the FDI policy which aims FDI as a medium for acquiring advanced technology and to mobilize foreign exchange resources. With the time and as per economic and political regimes there have been changes in the FDI policy too. The Industrial Policy of

1965, allowed MNCs to venture through technical collaboration in India. Therefore, the[1] government adopted a liberal attitude by allowing more frequent equity participation to foreign enterprise, and to accept equity capital in technical collaborations. To restrict outflow of foreign reserves in the form of remittances of dividends, profits, royalties the government had to adopt stringent foreign policy in 1970s. During this period the government adopted a selective and highly restrictive foreign policy as far as foreign capital, type of FDI and ownerships of foreign companies was concerned. Government setup Foreign Investment Board and enacted Foreign Exchange Regulations Act (FERA) in order to facilitate external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India. The shooting up of oil prices continued low exports and deterioration in balance of payment position during 1980s forced the government to make necessary changes in the foreign policy. The government introduced reforms in Industrial Sector which aimed at increasing competency, efficiency and growth in Industries through a stable pragmatic and non- discriminatory policy of FDI flows. In this critical face of Indian economy the government of India with the help of World Bank and IMF introduced the macro- economic stabilization and structural adjustment program. As a result, reforms in policy made India open its door for FDI inflows and adopted a more liberal foreign policy to restore the confidence of foreign investors. Under the new Foreign Investment Policy government of India constituted Foreign Investment Promotion Window System. The Foreign Equity cap was raised to 51 percent for the existing companies. Government had allowed the use of Foreign Brand names for domestically produced products which was restricted later. In recent years, India has become an attractive destination for FDI because of favorable government policies. For instance, Defense Sector increase up to 74 percent through automatic route and 100 percent through the government route, Foreign Exchange Management Act (FEMA) rules have been amended and allowed up to 20 percent FDI, Telecom Sector has been allowed up to 100 percent via automatic route. According to the World Investment Report released by the United Nation Conference on Trade and Development (UNCTAD), India remained among the top 10 (India rank :7) global economies in terms of FDI. It is estimated about 80 percent of the global respondents have planning to

1.Sapna Hooda (2011), A Study of FDI and Indian Economy: Ph.D Thesis, National Institue of Technology, Kurushreta.

invest in India in near future. Further, There are mainly two types of FDI—Horizontal and Vertical. However, two other types of FDI have emerged—Conglomerate and Platform FDI.

Horizontal: Under this type of FDI, a business expands its inland operation to another country. The business undertake the same activities but in foreign country.

Vertical: In this case, a business expands into another country by moving to a different level of supply chain. Thus business undertakes different activities overseas but these activities are related to main business.

Conglomerate: Under this type of FDI, a business undertakes unrelated business activities in a foreign country. This type is uncommon as it involves the difficulty of penetrating a new country and an entirely new market.

Platform: Here, a business expands into another country but the output from the business is then exported to a third country.

ROUTES OF FDI INFLOWS

a. **Automatic routes**- Under automatic route Investors do not required prior approval either by the Government of India or Reserve Bank of India. The investors are only required to notify the relevant Regional Office of RBI within 30 days of receipt of inward remittances and file the required documents with that office within 30 days of the issuance of share to foreign investors. The automatic approval route of the RBI was introduced to facilitate FDI inflows. However, during post policy period, the actual investment flows via the automatic route of RBI was insignificant to the total FDI flows. This was partly due to the fact that crucial areas like electronics, services and minerals were left out of the automatic approval route. Another limitation was the ceiling of 51 per cent on the foreign equity holding. An increasing number of proposals were cleared through the FIPB route at that time the automatic approval route became relatively unimportant. But since 2000 automatic approval route has gain its importance and accounts for a large part of FDI inflows.
b. **Government approval route**- all the sectors which have not been covered under automatic route and areas which are not prohibited for FDI are covered under

government route. These areas require prior approval of government through Foreign Investment Promotion Board. These funds are routed through authorised dealers within 30 days receipt of money, the company is required to intimate RBI about name and address of foreign investors, authorised dealers, detailed of government approval etc.

AN OVERVIEW OF FOREIGN PORTFOLIOS INVESTMENT

Foreign Portfolio Investment (FPI) consists of securities and other financial assets held by investors in another country. The investors do not obtain direct ownership of a company's assets and thus no direct management of a company. In the other words, the ingress of funds into country where foreigners deposit money in a country's stock and bond markets, sometime for speculations, can also be regarded as the Foreign Portfolios Investment. FPI emerged in India in 1992, as the India opened up its economy and allowed the investment in its domestic stock market. Since then FPI has emerged as a major source of private capital inflow in this country. The financial years from 1997 to 1999, witnessed a sudden decrease in Foreign Investment Institution (FII) inflows due to impact of Asian Crisis. However, during the year 1999-2002 flows had revived well. But in the year 2002-03 the FPI again drowned as per International Credit Rating Agency (ICRA) grade index due to poor performance of Indian stock market. In 2003-04 the FII's inflows shot up to great extent due to increase in the investment limit for FII's. In 2008-09, due to global depression there was heavy down-turn in the FII inflows that created a chaos in Indian Financial market. FPI trend is largely influence FII trends as both moved in same direction at very single point, mostly, they imitate each other. FPI has a significant impact on the economy as it brings in foreign exchange, which helps to finance the current account deficit and improves the balance of payment. It provides a stables source of capital, which can be used for long term investment in infrastructure and other developments projects. FPI promotes the development of the capital market, which provides companies with access to long term funding. Further FPI helps to improve corporate governance by making companies more accountable to their shareholders. There are two types of FPI- equity and debt. Equity refers to the purchase of shares of a company listed on the stock exchange, while debt FPI involves buying bonds and other debt instrument issued by the government or companies. Equity FPI is riskier than debt

FPI as it involves ownership of the company and is subject to fluctuations in the stock market. However, equity FPI offers higher returns than debt FPI, making it attractive to investors looking for higher yields.

AN OVERVIEW OF INDIAN ECONOMY

The Indian economy was one of the most stabilized and was the largest economy around the world. For almost 2 millennia (from the 1st century to the 17th century) the Indian economy contributed 35%-40% of the world's economy. By 1750, the Mughal Empire had a strong industrial manufacturing sector, with India contributing around 25% of the world industrial output, making it the most significant manufacturing hub in international commerce. Until the end of the 18th century, Mughal India accounted for almost 95% of the goods and textiles exported to Europe and Asia, while the import was as low as negligible and was still sufficient for the country.

During the British period, the Indian economy was hit majorly, and it came down to 4.2% of the world economy in 1950 from 24.4% in 1700. After Independence the Indian economy became the mix economy is owned by private businessmen, industrialist, and entrepreneurs and rest managed by Indian government. The Indian economy is highly dependent on the service sector because of its contribution to the GDP of India which is equal to 60% of the total. Top performing sectors of Indian economy are-

Agriculture- The agriculture sector contributes to 14% of the total GDP of India. Crops, horticulture, milk and animal husbandry, fishing, aquaculture, apiculture, sericulture, forestry, and others associated activities are all included.

Industry- The industrial sector contributes to 27% of the GDP. It comprises the manufacturing and sub manufacturing sectors.

Service- The service sectors contributes 59% of the total GDP of the India. It encompasses construction, retail, software, information technology, communications, hospitality, infrastructure operations, education, healthcare, banking, insurance, as well as many other economic activities.

Food processing- Recently Food processing has emerged as a high-growth, high-profit sector and is one of the focus sectors of the "Make in India" Initiative. The total consumption of the food and beverage segment in India is expected to increase from $369bn to $1.14tn by 2025. This sectors has huge potential in India due to world's largest markets, increasing urbanization within, income levels a high preference for packaged and processed food.

Strong economic growth in the first quarter of FY 2022-23 and helped India overcome the UK to become the fifth-largest economy after it recovered from repeated waves of covid19 pandemic shock.

IMPACT OF FDI AND FPI ON INDIAN ECONOMY

India is one of the countries that has been benefited significantly from Foreign Direct Investment and Foreign Portfolios Investment. However, It has own positive and negative impact on the economy.

Positive impact of FDI and FPI

Competitive economy- Foreign Direct Investment in the economy of a country helps to make it more competitive. Multinational corporations while setting up offices brings in cutting edge technologies that helps to boost the business and provide employment to a large number of people. A nation cannot generate huge investment on its own to upgrade the infrastructure in construction and power industries. It should be sourced from other countries that have foreign exchange reserves.

Elimination of monopoly- By inviting FDI, the government can eliminate monopoly of the local companies and benefits the customers because they can avail quality products. Moreover, it will force the companies to chart out the business strategy and deliver customer-centric services.

Human resource- The foreign company trains the local human resources to enhance their skill sets, thereby bridging the gap between education and employability. It plays an important role in enhancing the productivity of the employees.

Revenue to the host country- Host economy generates revenue through FDI as it access new technology and opportunity and it create employment in the market. Moreover, it also pays taxes to the host country and sources raw material from the local suppliers to manufacture the finished goods. It is a wonder option for the developing nations to improve the economy apart from becoming major exports destinations.

Cost cutting- Organization with FDI uses the local employees because they are cost effective and provide quality output. Therefore, it improves the balance sheet by eliminating the production overheads in the form of high wages.

Feasible for retail investors- FPI involves holding financial assets from a country outside of the investor's own. It doesn't provide the investor with direct ownership of a company's assets and relatively liquid depending on the volatility. So it is feasible for the retail investors.

Quicker return on investment- Investor is not actively manages the company into which they put the money so they face more liquidity and less risk when trying to sell the interest and they enjoy quicker return on investment**.**

Negative impact of FDI and FPI

Exploitation- Lax labour laws combined with unemployment in the developing countries leads to exploitation of workers by multinational corporations. They shift the manufacturing base from higher income nations to lower ones in order to save money nevertheless the working conditions at the news places are anything but good.

Draining of money- In spite of Foreign Direct Investment coming into the country by the company is basically developed to earn profits from the naïve customers. Therefore, the net amount earned is transferred to the parent nation. In addition, the human resources are forced to work for long hours with the absence of health insurance.

Loss of business for local companies- International corporations bringing in FDI are awash with funds compared to the local companies. The latter is forced to play second fiddle or

wind up after some time because they do not have the required financial muscle. It is an unfortunate situation as the country can never develop a local industrial base.

No direct management of investments- FPI consists of passive ownership; investors have no control over venture or direct ownership of property or a stake in a company.

Volatile- FPI is more liquid than FDI and offers the investor a chance for a quicker return on his money or a quicker exit. However, as with most investment offering a short term horizon, FPI assets can suffer from volatility. FPI money often departs the country of investment whenever there is uncertainty or negative impact on foreign land, which aggravate economic problems there.

TREND ANALYSIS OF FDI AND FPI INFLOW IN INDIAN ECONOMY

Table 1:- (2014-2022)

YEAR	FDI INFLOWS (US $ bn)	% GROWTH (Year on year)
2014-2015	45.1	25
2015-2016	55.5	23
2016-2017	60.2	8
2017-2018	60.9	1
2018-2019	62.0	2
2019-2020	74.3	20
2020-2021	81.9	10
2021-2022	83.5	2

Source- Reserve Bank of India

Table 2:- (2014-2022)

YEAR	FPI INFLOWS IN INDIA (US $ bn)
2013-2014	8.9
2014-2015	45.7
2015-2016	(2.5)
2016-2017	7.6
2017-2018	22.5
2018-2019	(5.5)
2019-2020	(3.0)
2020-2021	36.2
2021-2022	(16.0)

Source: Reserve Bank of India.

The above given data table 1 and 2 "Trend of FDI and FPI inflows" showing data for the past of eight years. The Researcher has been collected this data to study the trend and growth of Foreign Direct Investment and Foreign Portfolios Investment on Indian economy. Data has been calculated by applying Compound Annual Growth Rate formula (CAGR) and has been taken from Reserve Bank of India site.

Compound Annual Growth Rate Formula

$$CAGR = (V final / V begin)^{1/t} - 1$$

Where,

CAGR= compound annual growth rate

V begin= beginning value

V final = final value

t = time of years.

REVIEW OF LITERATURE

1. Laura Alfaro (2003)[2] in the paper "Foreign Direct Investment and Growth" stated that although it may seem natural to argue that foreign direct investment can convey great advantage to host countries, the benefits of FDI vary greatly across sectors. The FDI effects of growth in the primary, manufacturing, and services sectors.

2. Dunning John H. (2004)[3] in his study "Institutional Reform, FDI and European Transition Economic" studied the significance of institutional infrastructure and development as a determinant of FDI inflows into the European transition economics. The study examines the critical role of the institution environment (comprising both institution and the strategies and policies of organizations relating to these institutions) in reducing the transaction costs of both domestic and cross border business activity. By setting up an analytical framework the study identifies to determinants of FDI, and how these had changed over the recent years.

3. Iyare Sunday O, Bhaumik Pradip K, Arindam (2004)[4], in their work " Explaining FDI Inflows to India, China and the Caribbean: An extended Neighbourhood Approach" find out that FDI flows generally believed to be influenced by economic indicator like market size, export intensity, institution, etc, irrespective of the source and destination countries. This paper looks at FDI inflows in an alternative approach based on the concepts of neighbourhood and extended neighbourhood. The study shows that the neighbourhood concepts are widely applicable in different contexts particularly for china and India, and partly in the case of Caribbean. There are significant common factors in explaining FDI inflows in select regions. While a substantial fraction of FDI inflows may be explained by select variable country- specific factor and the idiosyncratic component account for more of the investment inflows in Europe, China, and India.

2.Laura Alfaro (2003): "Foreign Direct Investment and Growth: Does the Sector Matter?" Working Paper, Harvard Bussiness school, Harvard. Vol.8 No.1.

3. Dunning John H(2004): " International Reform, FDI and European Transition Economic", International business and government in the 21st century, Cambridge University Press, 1-34, www.reading.ac.uk.

4. Iyare Sunday O, Bhaumik Pradip K, Banik Arindam (2004): " Explaining FDI Inflows to India, China and the carribean": An Extended Neighborhood Approach Economic and Political weekly,pp.3398-340.

4. Sasidharan Subash and Ramanathan A. (2007)[5], study on "Foreign Direct Investment and Spillovers: Evidence from Indian Manufacturing." It is an attempt to empirically examine the spillover effects from the entry of foreign firms using a firm level data of the Indian manufacturing industries. Firm level data of Indian manufacturing industries are used for periods 1994-2002. They consider both horizontal and vertical spillover effects of FDI. Consistent with the results of the previous year studies, the study finds that no evidence of horizontal spillover effects. However the study finds negative vertical spillover effects.

5. Balasubramanyam V.N Sapsford David (2007)[6] in their article " Does India need a lot more FDI" compares the levels of FDI inflows in India and china found that FDI in India is one tenth of that of china. The paper also finds that India may not require increased FDI because of the structure and composition of India's manufacturing service sector and her endowments of human capital. The requirements of managerial and organizational skills of these industries are much lower than that of labor intensive industries such as those in china. Also, India has a large pool of well- trained engineers and scientist capable of adapting and restructuring imports know – how to suit local factor and product market condition all of [2] these factor promote effective spillovers of technology and know-how from foreign firms to locally own firms. The country may need much larger volumes of FDI than it current attract if it were to attain growth rates in excess of 10 per cent annum. Finally, they conclude that the country is now in a position to unbundle the FDI package effectively and rely on sources other than FDI for its requirements of capital.

6. Kulwinder Singh (2005)[7] stated in paper that the government while serious in its efforts to induce growth in the economy and country started with foreign investment in haphazard manner. While it is accepted that the government was under compulsion to liberalize cautiously, the understanding of foreign investment was lacking.

4.Sasidharan Subash and Ramanathan(2007): "Foreign Direct Investment and Spillover" international Journal of Trade and global Markets, 2007,vol.1,issue1,5-22.
5. Balasubramanyam V.N, sapford David(2007): "Does India need lot more FDI", Eonomic and Political weekly,pp.1549-1555.
6.Kulwinder singh (2005): " Foreign Direct Investment India: A critical Analysis of FDI from 1991-2005", papers.ssrn.com/sol3/pappers.cfm-id-822584.

7. Dr. Trinley Paldon (2021)[8], studied on "A Comparative Study of Foreign Portfolios investment and It's Effects on Stock Market in India During Covid -19" This research examines the factors that influence portfolio flows to India for the period 2019-2021. The macroeconomic determinants of portfolio flow to India are examined in this article, and it is discovered that lower exchange rate volatility and higher risk diversification opportunities are favourable to portfolio flows. Higher equity returns in other emerging markets, on the other hand, discourage similar movements. Domestic equities performance, exchange rate, interest rate difference, and domestic output growth are all traditional factors of portfolios movements flows that are found influencing the performance of emerging market stocks, interest rate differentials, and exchange rate volatility.

8. Prathapratim Pal (2015)[9] studied on "Foreign portfolios Investment stock market And Economic Development; A Case Study of India " The objective of this study is to examine the impact of Foreign Portfolio Investment on India's economy and industry. As FPI essentially interacts with the real economy via the stock market, the effect of stock market on the country's economic development will also be examined. The findings of this paper show that the perceived benefits of foreign portfolio investment have not been realized in India. From the results of this study it can be said that the mainstream argument that the entry of foreign portfolio investors will boost a country's stock market and consequently the economy, does not seem be working in India. The influx of FIIs has indeed influenced the secondary market segment of the Indian stock market. But the supposed linkage effects with the real economy have not worked in the way the mainstream model predicts. Instead there has been an increased uncertainty and skepticism about the stock market in this country. On the other hand, the surge in foreign portfolio investment in the Indian economy has introduced some serious problems of macroeconomic management for the policymakers. Uncertainty and volatility associated with FPI have not only reduced the degrees of maneurability available to the policymakers but have also forced them to take some measures which impose significant fiscal cost on the economy. Though this study focuses on India and draws policy implications based on the Indian experience, the results and policy implications of this study can be used to draw lessons for other developing which are at the same or similar level of development.

7. Dr.Trinley Paldon(2021): " A Comparative study of Portfolios Investment and Its Effects on stock market during covid- 19" Dodo Rangsang Journal ISSN: 2347-7180, vol issue09, No. 01.

8. Pratham Pal (2015): " Foreign Portfolios Investment stock Market and EconomicDevelopment: A Case Study in India",IIM Calcutta, www.researchgate.net/ publication/2222375917.

RESEARCH GAP

As per review of literature Numerous studies have been conducted on FDI of Indian economy regarding growth, investment, comparison studies between different countries, but there has been very little research on evaluation of FDI and FPI on Indian economy. Additionally, no study has been conducted to reflect impact of FDI and FPI on Indian economy.

STATEMENT OF PROBLEM

In view of the foregoing factors, the researcher has undertaken the present study to critically evaluate Foreign Direct Investment and Foreign Portfolios Investment on Indian economy in the transition phase.

OBJECTIVE OF THE STUDY

The study covers the following objectives-

1. To study the trends and pattern flows of FDI and FPI.

2. To assess the determinant of FDI and FPI.

3. To evaluate the impact of FDI and FPI on the economy.

HYPOTHESIS OF RESEARCH

The researcher has taken up two hypothesis for this study.

1. Flow of FDI and FPI shows positive trend over the period of 2014- 2024.

2. FDI and FPI have a positive impact on economic growth of the country.

RESEARCH DESIGN AND METHODOLOGY

RESEARCH DESIGN

Quantitative Method- Quantitative methods emphasize objective measurements and the statistical, mathematical, or numerical analysis of data collected through polls,

questionnaire, and surveys, or by manipulating pre- existing statistical data using computational techniques. It is similar to Deductive Research and it also term as Linear Research as it follows a Linear Path - Stating with testable hypothesis, Collection of data, Analyzing of data, and Accepting or Rejecting the hypothesis. Quantitative Research is generally associated with the positive or post positive paradigm. It usually involves collecting data and converting data into numerical form so that statistical calculation can be made and conclusion can be drawn.

RESEARCH METHODOLOGY

Data collection

Secondary data- This study will be based on secondary data. The required data will be collected from various sources like Reserve Bank of India, Ministry of Commerce and Industry Portal. Centre for Monitoring Indian Economy and Government of India, Books and Journal and Shodhganga Portal.

Primary data- At present the Researcher's feels that there will be no required of the primary data in this research.

Data Analysis

Time Series Analysis-Time series analysis is a specific way of analyzing a sequence of data points collected over an interval of time. Time series Analysis helps understanding the underlying causes of trends or systemic patterns over time. It can also use for forecasting and predictive analytics. As per requirement to analyze the trend of FDI & FPI **Compound Annual Growth Rate (CAGR)** will be used.

Data Representation- Data will be represented in the form of numbers and statistics like arranged in tables, charts and figures.

IMPORTANCE OF STUDY

It is very much visible from the above discussion that FDI and FPI play significant role in the development of an economy. The study will be attempted to evaluate FDI and FPI on Indian Economy. The study will be worked out with trend and pattern, determinants and investment flows to India. The study will also examine the role and impact of FDI and FPI on economic growth in India for the period of 2014-2024.

LIMITATION OF THE STUDY

All the research studies conducted in any discipline face various limitation and this study is no exception of the phenomena. The limitation of study is the assumption that Foreign Institutional Investors like FDI and FPI only cause for development of Indian economy.

TENTATIVE CHAPTERISATION

The following chapter has been proposed for the study.

1. Chapter 1 Introduction & Review of Literature.
2. Chapter 2 Overview of FDI and FPI and Indian Economy.
3. Chapter 3 Impact and trend analysis of FDI and FPI.
4. Chapter 4 Research Methodology, Data Analysis & Data Representation.
5. Chapter 5 Conclusion Findings & Suggestion.

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